

[Back to Contents](#)**(d) Stock options**

At December 31, 2006, stock options plans (excluding Lucent derived plans) were as follows:  
*(in number of options)*

	1998 Plan	1999 Plans	1999-2000 U.S. Plans	2000 Plans			
Exercise price	€20.52	€28.40	US\$21.40-US\$84.88	€48.00	€48.00	€65.00	€64.00
Exercise period							
From				04/01/03 04/01/05	07/01/03 07/01/05	12/13/03 12/13/05	12/13/01 12/13/04
To	12/09/03 12/31/05	09/08/04 12/31/05		12/31/05 12/31/07	06/30/04 06/30/06	12/31/05 12/12/07	12/12/08 12/12/08
Granted	11,602,500	-	-	-	-	-	-
Exercised	-	-	-	-	-	-	-
Forfeited	-	-	-	-	-	-	-
Expired	-	-	-	-	-	-	-
Outstanding at December 31, 1998	11,602,500	-	-	-	-	-	-
Granted	-	545,000	7,866,630	-	-	-	-
Exercised	-	-	-	-	-	-	-
Forfeited	(427,250)	-	(143,650)	-	-	-	-
Expired	-	-	-	-	-	-	-
Outstanding at December 31, 1999	11,175,250	545,000	7,722,980	-	-	-	-
Granted	-	-	19,407,838	15,239,250	8,905,804	1,235,500	306,700
Exercised	-	-	(393,296)	(10,000)	-	-	-
Forfeited	(412,000)	(46,250)	(3,060,818)	(923,120)	(47,328)	-	-
Expired	-	-	-	-	-	-	-
Outstanding at December 31, 2000	10,763,250	498,750	23,676,704	14,306,130	8,858,476	1,235,500	306,700
Exercised	-	-	(261,205)	(3,000)	(376)	-	-
Forfeited	(60,000)	(5,000)	(3,327,376)	(161,500)	(122,364)	(130,150)	(3,600)
Expired	-	-	-	-	-	-	-
Outstanding at December 31, 2001	10,703,250	493,750	20,088,123	14,141,630	8,735,736	1,105,350	303,100
Exercised	-	-	-	-	-	-	-
Forfeited	(306,000)	(22,500)	(3,871,401)	(581,075)	(37,684)	(40,000)	(5,100)
Expired	-	-	-	-	-	-	-
Outstanding at December 31, 2002	10,397,250	471,250	16,216,722	13,560,555	8,698,052	1,065,350	298,000

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<i>(in number of options)</i>	1998 Plan	1999 Plans	1999-2000 U.S. Plans	2000 Plans			
Exercised	-	-	-	-	-	-	-
Forfeited	(165,000)	(17,500)	(2,797,641)	(320,500)	(6,524)	(32,500)	(86,421)
Expired	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2003</b>	<b>10,232,250</b>	<b>453,750</b>	<b>13,419,081</b>	<b>13,240,055</b>	<b>8,691,528</b>	<b>1,032,850</b>	<b>211,579</b>
Exercised	-	-	-	-	-	-	-
Forfeited	(110,000)	(10,000)	(2,276,230)	(174,000)	(5,429,868)	(11,000)	(3,838)
Expired	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2004</b>	<b>10,122,250</b>	<b>443,750</b>	<b>11,142,851</b>	<b>13,066,055</b>	<b>3,261,660</b>	<b>1,021,850</b>	<b>207,741</b>
Exercised	-	-	-	-	-	-	-
Forfeited	(237,500)	(22,500)	(476,095)	(203,750)	(2,956)	(18,000)	(10,241)
Expired	-	-	(608,141)	-	-	-	-
<b>Outstanding at December 31, 2005</b>	<b>9,884,750</b>	<b>421,250</b>	<b>10,058,615</b>	<b>12,862,305</b>	<b>3,258,704</b>	<b>1,003,850</b>	<b>197,500</b>
Exercised	-	-	-	-	-	-	-
Forfeited	-	-	-	(51,000)	(1,652)	(9,500)	(1,500)
Expired	(9,884,750)	(421,250)	(1,225,128)	(5,182,500)	(3,257,052)	(448,500)	-
<b>Outstanding at December 31, 2006</b>	<b>-</b>	<b>-</b>	<b>8,833,487</b>	<b>7,628,805</b>	<b>-</b>	<b>545,850</b>	<b>196,000</b>

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<i>(in number of options)</i>										
2001 Plans										
Exercise price	€50.00	€50.00	€41.00	€39.00	€32.00	€19.00	€9.00	€20.80	€9.30	€20.80
Exercise period										
From	03/07/02 03/07/05	07/01/04 07/01/05	04/02/02	04/02/02	06/15/02 06/15/05	09/03/02 09/03/05	11/15/02 11/15/05	12/19/02 12/19/05	12/19/02 12/19/05	01/01/05 01/01/06
To	03/06/09 03/06/09	06/30/05 06/30/06	04/01/09	04/01/09	06/14/09 06/14/09	09/02/09 09/02/09	11/14/09 11/14/09	12/18/09 12/18/09	12/18/09 12/18/09	12/31/05 12/31/06
Granted	37,668,588	275,778	48,850	2,500	977,410	138,200	162,000	27,871,925	565,800	935,660
Exercised	-	-	-	-	-	-	-	-	-	-
Forfeited	(1,075,160)	(825)	(7,050)	-	(19,350)	-	-	-	-	-
Expired	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2001	36,593,428	274,953	41,800	2,500	958,060	138,200	162,000	27,871,925	565,800	935,660
Exercised	-	-	-	-	-	-	-	-	-	-
Forfeited	(1,271,749)	(2,343)	(5,500)	-	(21,175)	(10,300)	(30,000)	(2,283,225)	(37,200)	(16,840)
Expired	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2002	35,321,679	272,610	36,300	2,500	936,885	127,900	132,000	25,588,700	528,600	918,820
Exercised	-	-	-	-	-	-	-	-	(64,444)	-
Forfeited	(6,345,632)	(150)	(24,050)	-	(119,780)	(13,050)	(23,000)	(2,517,719)	(68,750)	(23,950)
Expired	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2003	28,976,047	272,460	12,250	2,500	817,105	114,850	109,000	23,070,981	395,406	894,870
Exercised	-	-	-	-	-	-	(3,000)	-	(42,574)	-
Forfeited	(1,047,721)	(240)	-	-	(33,484)	(8,800)	-	(2,539,840)	(13,326)	(240)
Expired	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2004	27,928,326	272,220	12,250	2,500	783,621	106,050	106,000	20,531,141	339,506	894,630
Exercised	-	-	-	-	-	-	-	-	(2,500)	-
Forfeited	(806,956)	(194,670)	-	-	(15,981)	(2,250)	-	(1,547,776)	(101)	(640)
Expired	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2005	27,121,370	77,550	12,250	2,500	767,640	103,800	106,000	18,983,365	336,905	893,990
Exercised	-	-	-	-	-	-	(24,000)	-	(149,967)	-
Forfeited	(623,065)	(330)	-	-	(22,590)	(8,000)	-	(3,606,350)	(77,837)	(522,710)
Expired	-	(77,220)	-	-	-	-	-	-	-	-
Outstanding at December 31, 2006	26,498,305	-	12,250	2,500	745,050	95,800	82,000	15,377,015	109,101	371,280

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2002 Plans								
Exercise price	€17.20	€16.90	€14.40	€13.30	€5.20	€3.20	€4.60	€5.40
Exercise period								
From	02/15/03 02/15/06	04/02/03	05/13/03 05/13/06	06/03/03 06/03/06	09/02/03 09/02/06	10/07/03 10/07/06	11/14/03 11/14/06	12/02/03 12/02/06
To	02/14/10 02/14/10	04/01/10	05/12/10 05/12/10	06/02/10 06/02/10	06/01/10 06/01/10	10/06/10 10/06/10	11/13/10 11/13/10	12/01/10 12/01/10
Granted	123,620	55,750	54,300	281,000	1,181,050	30,500	111,750	54,050
Exercised	-	-	-	-	-	-	-	-
Forfeited	(14,250)	(1,000)	-	(17,660)	(64,250)	-	-	-
Expired	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2002</b>	<b>109,370</b>	<b>54,750</b>	<b>54,300</b>	<b>263,340</b>	<b>1,116,800</b>	<b>30,500</b>	<b>111,750</b>	<b>54,050</b>
Exercised	-	-	-	-	(32,182)	(853)	(3,375)	-
Forfeited	(20,425)	(13,000)	(5,250)	(14,090)	(165,232)	(9,138)	(4,250)	(10,250)
Expired	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2003</b>	<b>88,945</b>	<b>41,750</b>	<b>49,050</b>	<b>249,250</b>	<b>919,386</b>	<b>20,509</b>	<b>104,125</b>	<b>43,800</b>
Exercised	-	-	-	-	(204,147)	(3,165)	(20,838)	(3,562)
Forfeited	(5,578)	(6,000)	(4,469)	(5,771)	(60,849)	(3,885)	(7,294)	(2,000)
Expired	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2004</b>	<b>83,367</b>	<b>35,750</b>	<b>44,581</b>	<b>243,479</b>	<b>654,390</b>	<b>13,459</b>	<b>75,993</b>	<b>38,238</b>
Exercised	-	-	-	-	(228,445)	(3,000)	(25,873)	(15,685)
Forfeited	(10,537)	(1,000)	(3,281)	(11,500)	(15,544)	-	-	(10,918)
Expired	-	-	-	-	-	-	-	-
Adjustments	-	-	-	-	-	-	1,104	-
<b>Outstanding at December 31, 2005</b>	<b>72,830</b>	<b>34,750</b>	<b>41,300</b>	<b>231,979</b>	<b>410,401</b>	<b>10,459</b>	<b>51,224</b>	<b>11,635</b>
Exercised	-	-	-	-	(159,016)	(1,649)	(23,524)	-
Forfeited	(18,250)	(7,500)	(4,000)	(4,479)	(5,063)	(251)	(968)	(480)
Expired	-	-	-	-	-	-	-	-
Adjustments	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2006</b>	<b>54,580</b>	<b>27,250</b>	<b>37,300</b>	<b>227,500</b>	<b>246,322</b>	<b>8,559</b>	<b>26,732</b>	<b>11,155</b>

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2003 Plans								
Exercise price	€6.70	€6.70	€7.60	€8.10	€9.30	€10.90	€11.20	€11.10
Exercise period								
From	03/07/04 03/07/07	07/01/06 07/01/07	06/18/04 06/18/07	07/01/04 07/01/07	09/01/04 09/01/07	10/01/04 10/01/07	11/14/04 11/14/07	12/01/04 12/01/07
To	03/06/11 03/06/11	06/30/07 06/30/08	06/17/11 06/17/11	06/30/11 06/30/11	08/31/11 08/31/11	09/30/11 09/30/11	11/13/11 11/13/11	11/30/11 11/30/11
Granted	25,626,865	827,348	338,200	53,950	149,400	101,350	63,600	201,850
Exercised	(7,750)	(28)	-	-	-	-	-	-
Forfeited	(1,583,230)	(17,193)	-	-	-	-	-	-
Expired	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2003</b>	<b>24,035,885</b>	<b>810,127</b>	<b>338,200</b>	<b>53,950</b>	<b>149,400</b>	<b>101,350</b>	<b>63,600</b>	<b>201,850</b>
Exercised	(1,221,749)	(111)	(6,944)	(473)	(1,603)	-	-	(562)
Forfeited	(1,142,822)	(605)	(31,654)	(23,951)	(6,300)	(29,376)	(2,000)	(37,300)
Expired	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2004</b>	<b>21,671,314</b>	<b>809,411</b>	<b>299,602</b>	<b>29,526</b>	<b>141,497</b>	<b>71,974</b>	<b>61,600</b>	<b>163,988</b>
Exercised	(1,566,542)	(147)	(10,746)	(1,842)	(833)	-	-	-
Forfeited	(477,617)	(467)	(10,378)	(5,434)	(2,735)	(10,291)	(1,500)	(29,501)
Expired	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2005</b>	<b>19,627,155</b>	<b>808,797</b>	<b>278,478</b>	<b>22,250</b>	<b>137,929</b>	<b>61,683</b>	<b>60,100</b>	<b>134,487</b>
Exercised	(2,097,255)	(14,658)	(24,573)	(9,154)	(2,062)	(906)	-	(7,660)
Forfeited	(362,806)	(317)	(4,164)	(1,001)	(7,641)	(4,594)	(49,500)	(34,616)
Expired	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2006</b>	<b>17,167,094</b>	<b>793,822</b>	<b>249,741</b>	<b>12,095</b>	<b>128,226</b>	<b>56,183</b>	<b>10,600</b>	<b>92,211</b>

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2004 Plans								
(in number of options)								
Exercise price	€13.20	€13.10	€12.80	€11.70	€9.90	€9.80	€11.20	€11.90
Exercise period								
From	03/10/05 03/10/08	04/01/05 04/01/08	05/17/05 05/17/08	07/01/05 07/01/08	09/01/05 09/01/08	10/01/05 10/01/08	11/12/05 11/12/08	12/01/05 12/01/08
To	03/09/12 03/09/12	03/31/12 03/31/12	05/16/12 05/16/12	06/30/12 06/30/12	08/31/12 08/31/12	09/30/12 09/30/12	11/11/12 11/11/12	11/30/12 11/30/12
Granted	18,094,315	48,100	65,100	313,450	38,450	221,300	69,600	42,900
Exercised	-	-	-	-	-	-	-	-
Forfeited	(724,065)	(7,350)	(2,550)	(13,500)	-	-	-	-
Expired	-	-	-	-	-	-	-	-
Outstanding at December 31, 2004	17,370,250	40,750	62,550	299,950	38,450	221,300	69,600	42,900
Exercised	-	-	-	-	-	(300)	-	-
Forfeited	(1,017,737)	(11,292)	(6,050)	(22,450)	(1,300)	(27,700)	(800)	(5,000)
Expired	-	-	-	-	-	-	-	-
Outstanding at December 31, 2005	16,352,513	29,458	56,500	277,500	37,150	193,300	68,800	37,900
Exercised	(700)	-	-	(2,399)	(822)	(11,330)	-	-
Forfeited	(1,131,200)	(3,467)	(3,750)	(10,638)	(5,778)	(44,297)	(6,100)	(1,938)
Expired	-	-	-	-	-	-	-	-
Outstanding at December 31, 2006	15,220,613	25,991	52,750	264,463	30,550	137,673	62,700	35,962

2005 Plans					
(in number of options)					
Exercise price	€11.41	€10.00	€8.80	€9.80	€10.20
Exercise period					
From	01/03/06 01/03/09	03/10/06 03/10/09	06/01/06 06/01/09	09/01/06 09/01/09	11/14/06 11/14/09
To	01/02/13 01/02/13	03/09/13 03/09/13	05/31/13 05/31/13	08/31/13 08/31/13	11/13/13 11/13/13
Granted	497,500	16,756,690	223,900	72,150	54,700
Exercised	-	-	-	-	-
Forfeited	(17,400)	(707,210)	(8,800)	-	-
Expired	-	-	-	-	-
Outstanding at December 31, 2005	480,100	16,049,480	215,100	72,150	54,700
Exercised	(7,558)	(158,438)	(965)	-	(1,250)
Forfeited	(61,087)	(654,528)	(27,243)	(7,100)	(8,350)
Expired	-	-	-	-	-
Outstanding at December 31, 2006	411,455	15,236,514	186,892	65,050	45,100

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(in number of options)		2006 Plans			
Exercise price		€11.70	€12.00	€9.30	€10.40
Exercise period					
From		03/08/07 03/08/10	05/15/07 05/15/10	08/16/07 08/16/10	11/08/07 11/08/07
To		03/07/14 03/07/14	05/14/14 05/14/14	08/15/14 08/15/14	11/07/14 11/07/14
Granted		17,009,320	122,850	337,200	121,100
Exercised		-	-	-	-
Forfeited		(482,130)	(7,100)	-	-
Expired		-	-	-	-
<b>Outstanding at December 31, 2006</b>		<b>16,527,190</b>	<b>115,750</b>	<b>337,200</b>	<b>121,100</b>

The option plans of companies that were acquired by Alcatel provide for the issuance of Alcatel-Lucent shares or ADSs upon exercise of options granted under such plans in an amount determined by applying the exchange ratio used in the acquisition to the number of shares of the acquired company that were the subject of the options (see the following table).

The following table sets forth the U.S. and Canadian companies that issued these plans, the range of exercise prices, the number of outstanding and exercisable options as of December 31, 2006, the weighted average exercise price and the weighted average exercise period.

Company	Exercise price	Outstanding options			Exercisable options	
		Number outstanding at 31/12/2006 <sup>(1)</sup>	Weighted remaining exercise period (years)	Weighted average exercise price	Amount exercisable at 31/12/2006 <sup>(1)</sup>	Weighted average exercise price
Packet Engines	US\$0.29-US\$0.86	7,372	1.42	0.71	7,372	0.71
Xylan	US\$0.05-US\$18.14	977,283	1.50	9.57	977,283	9.57
Internet Devices Inc.	US\$0.26-US\$1.17	23,980	1.88	0.92	23,980	0.92
DSC	US\$16.57-US\$44.02	24,550	0.63	23.69	24,550	23.69
Genesys	US\$0.01-US\$41.16	2,638,367	2.38	21.9	2,638,367	21.90
Astral Point	€0.29-€58.71	37,634	4.45	22.64	37,634	22.64
Telera	€0.43-€6.36	122,958	3.86	5.08	122,958	5.08
Imagic TV	€2.84-€64.68	55,405	0.88	20.48	55,405	20.48
TiMetra	€0.53-€7.97	1,356,659	4.17	6.43	1,154,662	6.17
Spatial Wireless	€0.24 - €9.10	463,536	7.26	3.78	274,232	3.49
<b>Total number of options</b>		<b>5,707,744</b>			<b>5,316,443</b>	

(1) In number of Alcatel-Lucent shares.

Except in the case of Astral Point, Telera, Imagic TV, TiMetra and Spatial Wireless, upon exercise, Alcatel-Lucent will not issue new ADSs (or, consequently, shares); the options set forth in the above table for Packet Engines, Xylan, Internet Devices, DSC and Genesys entitle the holders to purchase existing ADSs held by Group subsidiaries.

#### Former Lucent stock-based awards:

As indicated in the merger agreement with Lucent, each outstanding option to purchase shares granted under Lucent's compensation or benefit plans or agreements pursuant to which shares may be issued (excluding the Lucent 2001 employee stock purchase plan), whether vested or not vested, was converted into a right to acquire, the number of Alcatel-Lucent ordinary shares determined by applying the exchange ratio used in the transaction. The exercise price is equal to the product of (a) the quotient of (i) the US dollar exercise price per share otherwise purchasable pursuant to such Lucent stock option, divided by (ii) the exchange ratio, multiplied by the (b) euro exchange rate of € 1.22.



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Stock option activity for former Lucent plans is as follows:

(in number of options)

	Former Lucent plans					
Exercise price	€9.35	€10.89	€15.28	€12.40	€5.49	€6.88
Exercise period						
From	01/11/07	01/12/06	01/12/06	01/12/06	01/12/06	01/12/06
To	31/10/13	30/11/12	30/11/11	30/11/10	15/12/09	24/11/08
Outstanding at December 1, 2006	6,088,483	4,576,237	8,010,525	7,658,168	5,328,118	9,205,331
Granted	-	-	-	-	-	-
Exercised	-	-	-	-	-	-
Expired	(73,030)	(21,892)	(19,751)	(12,200)	(7,243)	(13,966)
Outstanding at December 31, 2006	6,015,453	4,554,345	7,990,774	7,645,968	5,320,875	9,191,365

(in number of options)

(in number of options)	Former Lucent plans						
Exercise price	€61.93	€224.93	€76.64	€46.69	€0.28 to 10.00	€10.01 to 20.00	€20.01 and more
Exercise period							
From	01/12/06	01/12/06	01/12/06	01/12/06	01/12/06	01/12/06	01/12/06
To							
	25/12/10	31/05/10	05/10/07	19/01/07	03/12/06 03/05/14	01/12/06 01/12/14	01/12/06 05/01/12
Outstanding at December 1, 2006	1,484,527	1,260,610	1,387,253	949,001	928,132	1,126,872	10,776,344
Granted	-	-	-	-	-	-	-
Exercised	-	-	-	-	-	-	-
Expired	-	(150)	-	-	(20,940)	(17,981)	(64,652)
Outstanding at December 31, 2006	1,484,527	1,260,460	1,387,253	949,001	907,192	1,108,891	10,711,692

Moreover, each unvested restricted stock unit granted under Lucent's compensation or benefit plans or agreements was converted into the number of Alcatel-Lucent ordinary shares determined by applying the exchange ratio used in the transaction.

The following table summarizes unvested restricted stock unit activity:

**Former Lucent restricted unit activity**

(in number of stocks)

Unvested at December 1, 2006	1,684,575
Granted	-
Vested	(961)
Forfeited	(20,918)
Unvested at December 31, 2006	1,662,696

**(e) Share-based payments**

Only stock option plans established after November 7, 2002, and whose stock options were not yet fully vested at January 1, 2005, are restated according to IFRS 2 "Share-based Payment". Those stock options that were fully vested at December 31, 2004 do not therefore result in either a charge in 2004 or in subsequent accounting periods.

By simplification, during the vesting period and as a result of employees leaving the Group, no option cancellations are considered when determining compensation expense for stock options granted. During the vesting period and as a result of employees leaving the Group, the accounting impact of option cancellations is recognized when the cancellation is made. For options cancelled before the end of the vesting period, this can mean correcting the charge, recognized in prior accounting periods, in the period following the cancellation.

Options cancelled after the vesting period and options not exercised do not result in correcting charges previously recognized.



**Fair value of granted options for historical Alcatel plans**

The fair value of stock options is measured using the Cox–Ross–Rubinstein Binomial model. This allows behavioral factors governing the exercise of stock options to be taken into consideration and to consider that all options will not be systematically exercised by the end of the exercise period but could be exercised earlier. The expected volatility is determined as being the implied volatility at the grant date.

Assumptions for the Alcatel plans representing more than 1,000,000 outstanding options are as follows:

- expected volatility: 60% for the 2002 and March 2003 plans, 40% for the 2004 and 2005 plans and 32% for the 2006 plans;
- risk-free rate: 4.58% for the 2002 plans, 3.84% for the March 2003 plan, 3.91% for the March 2004 plan, 3.50% for the March 2005 plan and for the March 2006 plan;
- distribution rate on future income: 0% in 2003, 2004 and 2005 and 1% for later years.

Based on these assumptions, the fair values of Alcatel options used in the calculation of compensation expense for share-based payments are as follows:

- 2002 plans: weighted average fair value of €2.48;
  - March 2003 plan with an exercise price of €6.70: fair value of €3.31;
  - March 2004 plan with an exercise price of €13.20: fair value of €5.06;
  - March 2005 plan with an exercise price of €10.00: fair value of €3.72;
  - March 2006 plans with an exercise price of €11.70: fair value of €3.77.
- Other plans have fair values between €2.19 and €4.90 and a weighted average fair value of €3.75.

**Former Lucent stock-based awards:**

The fair values have been recalculated at the business combination date with the following assumptions:

- expected volatility: 26.20% to 32.37% depending on the remaining life of the options;
- risk-free rate: 3.35% to 3.62% depending on the remaining life of the options;
- distribution rate on future income: 0.8%.

Under IFRS, the estimated fair value of outstanding stock awards as of the business combination date amounts to €133 million, consisting of €96 million for vested options and €37 million for unvested options.

**Impact on net income (loss) of share-based payments resulting from stock option or stock purchase plans**

Compensation expense recognized for share-based payments in accordance with IFRS 2 has been accounted for as follows:

(in millions of euros)	2006	2005	2004
Compensation expense for share-based payments	63	67	58
These amounts are presented in the income statement under the following captions:			
- cost of sales	19	21	18
- administrative and selling expenses	28	29	26
- research and development costs	16	17	14

The amounts above include 11 months of Alcatel stand alone and 1 month of Alcatel Lucent combined. The entire expense recognized in application of IFRS 2 concerns share-based payments. None of these transactions results in the outflow of cash.

**Characteristics of subscription stock option plans or stock purchase plans recognized in compliance with IFRS 2****Vesting conditions**

The following rules are applicable to all plans granted by Alcatel in 2002, 2003, 2004, 2005 and 2006:

- Vesting is gradual: options vest in successive portions over 4 years, for which 25% of the options are vested if the employee remains employed after 12 months and, for each month after the first year, 1/48<sup>th</sup> additional options are vested if the employee remains employed by the Group.
- Exercise period depends on country: in some countries, stock options can be exercised as soon as they are vested; in other countries, a four-year period of inalienability exists. Whatever the beginning of the period is, stock options terminate 8 years after the grant date.

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For plans of companies that Alcatel acquired, the vesting conditions and the options life of the original plan remain in place.  
 For former Lucent stock option plans, the vesting rules remain in place. Stock options vest linearly over 4 years by 25% each year and can be exercised as soon as they are vested.

### Conditions of settlement

All stock options granted are exclusively settled in shares using new shares.

### Number of options granted and change in number of options for historical Alcatel plans

Stock option plans covered by IFRS 2 and the change in number of stock options generating compensation expense are:

Number of options granted and change in stock option plans covered by IFRS 2 and the change in number of stock options generating compensation expense are:										Total
(in number of options)	2002 Plans	2003 Plans	2004 Plans	2005 Plans	2006 Plans					
Exercise price	€4.60 to 5.40	€6.70 €7.60 to 11.20	€13.20 €9.80 to 13.10	€10.00 €8.80 to 11.41	€11.70 €9.30 to 12.00					
Exercise period										
From	14/11/03 02/12/06	07/03/04 07/03/07	18/06/04 01/12/07	10/03/05 10/03/08	01/04/05 01/12/08	10/03/06 10/03/09	03/01/06 01/09/09	08/03/07 08/03/10	15/05/07 08/11/10	
To	13/11/10 01/12/10	06/03/11 06/03/11	17/06/11 30/11/11	09/03/12 09/03/12	31/03/12 30/11/12	09/03/13 09/03/13	31/01/13 31/08/13	07/03/14 07/03/14	14/05/14 07/11/14	
Outstanding at December 31, 2004	65,181	12,079,954	536,493	17,370,250	775,500	-	-	-	30,827,378	
Granted	-	-	-	-	-	16,756,690	848,250	-	17,604,940	
Exercised	(20,774)	(1,172,079)	(10,050)	-	(300)	-	-	-	(1,203,203)	
Forfeited	(4,907)	(357,667)	(44,854)	(1,017,737)	(74,592)	(707,210)	(26,200)	-	(2,233,167)	
Expired	-	-	-	-	-	-	-	-	-	
Outstanding at December 31, 2005	39,500	10,550,208	481,589	16,352,513	700,608	16,049,480	822,050	-	44,995,948	
Of which could be exercised	29,189	5,809,745	271,665	7,316,197	208,096	-	-	-	13,634,892	
Granted	-	-	-	-	-	-	-	17,009,320	581,150	
Exercised	(11,757)	(1,579,975)	(33,224)	(700)	(14,551)	(158,438)	(9,773)	-	(1,808,418)	
Forfeited	(724)	(271,661)	(76,114)	(1,131,200)	(75,968)	(654,528)	(103,780)	(482,130)	(7,100)	
Expired	-	-	-	-	-	-	-	-	-	
Outstanding at December 31, 2006	27,019	8,698,752	372,451	15,220,613	610,089	15,236,514	708,497	16,527,190	574,050	
Of which could be exercised	27,019	7,561,988	291,276	10,445,679	351,216	6,451,964	279,269	-	25,408,411	
Average share price at exercise during the period	10.52	11.29	11.15	11.00	11.47	11.95	11.93	-	11.31	

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For Lucent stock option plans covered by IFRS 2, the change in number of stock options generating compensation expense are:  
(in number of options)

Exercise price	Former Lucent plans					
	€9.35	€10.89	€15.28	€12.40	€0.28 to 10.00	€10.01 to 20.00
Exercise period						
From	01/11/07	01/12/06	01/12/06	01/12/06	01/12/06	01/12/06
To	31/10/13	30/11/12	30/11/11	30/11/10	03/12/0603/05/14	01/12/0601/02/14
<b>Outstanding at December 1, 2006</b>	<b>6,088,483</b>	<b>4,569,566</b>	<b>5,953,537</b>	<b>954,040</b>	<b>283,121</b>	<b>606,827</b>
Granted	-	-	-	-	-	-
Exercised	-	-	-	-	-	-
Expired	(73,030)	(21,860)	(14,679)	(1,520)	-	(185)
<b>Outstanding at December 31, 2006</b>	<b>6,015,453</b>	<b>4,547,706</b>	<b>5,938,858</b>	<b>952,520</b>	<b>283,121</b>	<b>606,642</b>
Of which could be exercised	-	1,147,387	3,741,160	835,188	78,365	156,311
<b>Average share price at exercise during the period</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

**(f) Treasury stock**

Alcatel has established a buy-back program for the ordinary shares, authorized at the shareholders' ordinary annual general meetings held on June 4, 2004, May 20, 2005 and September 7, 2006, for the purpose of allocating them to employees of the group under the terms provided by law, of honoring obligations arising from the issuance of securities conferring a right to the capital of the company or for the purpose of using them in an exchange or as payment for external growth transactions. The purchases are limited to a maximum of 10% of the capital stock, and authorization expires 18 months from the most recent shareholders' general meeting at which authorization was given. As part of this program, no shares were purchased as of December 31, 2006 (no shares were purchased in 2005 and 2004).

Alcatel-Lucent shares owned by Group consolidated subsidiaries were €1,572 million at December 31, 2006 (1,575 million at December 31, 2005 and €1,607 million at December 31, 2004). They are deducted at cost from retained earnings.

**(g) Minority interests**

(in millions of euros)

<b>Balance at January 1, 2004</b>	<b>388</b>
Other changes <sup>(1)</sup>	(84)
Minority interests in 2004 income	69
<b>Balance at December 31, 2004</b>	<b>373</b>
Other changes <sup>(2)</sup>	63
Minority interests in 2005 income	41
<b>Balance at December 31, 2005</b>	<b>477</b>
Other changes <sup>(2)</sup>	(24)
Minority interests in 2006 income	45
<b>Balance at December 31, 2006</b>	<b>498</b>

(1) This amount relates to translation adjustments and to changes related to discontinued operations.

(2) This amount primarily relates to translation adjustments.

**Note 24 – Compound Financial Instruments**

*Compound Financial Instruments Issued by Alcatel before the Transaction with Lucent*  
(In millions of euros)

	ORANE			OCEANE		
	December 31, 2006	December 31, 2005	December 31, 2004	December 31, 2006	December 31, 2005	December 31, 2004
<b>Balance sheet</b>						
Capital stock	242	242	242	-	-	-
Additional paid-in capital	403	403	403	-	-	-
Reserves (prepaid interest)	(132)	(132)	(132)	-	-	-
Reserves (equity component)	-	-	-	105	126	146
<b>Shareholders' equity</b>	<b>513</b>	<b>513</b>	<b>513</b>	<b>105</b>	<b>126</b>	<b>146</b>
Convertible bonds – due after one year	-	-	-	916	901	886
Convertible bonds – due within one year (interest paid and payable)	-	-	-	49	48	49
<b>Financial debt</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>965</b>	<b>949</b>	<b>935</b>
<b>Income statement</b>						
Finance costs relating to gross debt	-	-	-	(70)	(68)	(67)

**(a) ORANE (Obligations Remboursables en Actions Nouvelles ou Existantes)**

On December 19, 2002, Alcatel issued 120,786,517 notes, of nominal value €5.34 each, mandatorily redeemable for new or existing ordinary shares (ORANE) (one share for one note), for a total amount of €645 million, with a maturity date of December 23, 2005. The notes carried an annual interest rate of 7.917%. On January 2, 2003, Alcatel paid the full amount of the discounted interest of €132 million, calculated from the settlement date to the maturity date at a discount rate of 7.917%, which amounted to €1.09115 for each note.

During 2004, 3,660 notes were repaid by issuance of 3,212 shares. During 2005, and prior to the redemption of the notes on December 23, 2005, 10,560 notes were repaid by issuance of 10,307 shares (the difference between the number of notes repaid and the number of shares issued (253) results from the impact of discounted interest at the time of the debt issuance).

The notes were entirely redeemed on December 23, 2005 by the issuance of 120,769,959 shares. For the repayment of the ORANEs, Alcatel issued only new shares.

The ORANE notes were considered as a component of equity that was classified from the outset in shareholders' equity. As the discounted interest was paid in full on January 2, 2003, that amount was also recognized in shareholders' equity and no interest expense was recognized either in the 2004 or 2005 income statements. The net amount of €513 million received from the note issuance was therefore reclassified to shareholders' equity in the opening balance sheet at January 1, 2004 in accordance with IFRSs.

**(b) OCEANE (Obligations Convertibles ou Échangeables en Actions Nouvelles ou Existantes)**

On June 12, 2003, Alcatel issued 63,192,019 bonds having a nominal value of €16.18 each, convertible into new or existing ordinary shares (OCEANE) for a total value of €1,022 million. These bonds mature on January 1, 2011 and bear interest at a rate of 4.75% *per annum*.

These bonds have a buy-back option that Alcatel-Lucent can exercise in the period from June 12, 2008 to December 31, 2010.

The OCEANE bonds are considered as a compound financial instrument containing an equity component and a debt component. Early application of the buy-back option does not require any separate accounting, as the repurchase price is at nominal value and the buy-back option is a derivative closely linked to the debt issuance. The buy-back option is therefore included in the debt component of this compound financial instrument. At the time of issuance, the debt component was valued at €860.7 million, which corresponded to the present value of a similar bond issue but without any equity component. The equity component included in shareholders' equity was valued at €161.8 million at the date of issuance. The contra entry to the equity component, which is amortized to income over the life of the debt, increases the interest cost of this financial debt by €21.6 million in 2006, €20.0 million in 2005 and by €18.6 million in 2004.

The effective rate of interest of the debt component is 7.83% including debt issuance costs.

At December 31, 2006, the fair value of the debt component of the OCEANE bonds was €1,059 million (see Note 26h) and the market value of the OCEANE bonds was €1,144 million.

[Back to Contents](#)**(c) Compound Financial Instruments Issued by Lucent before the Merger**

The following table summarizes components of convertible bonds.

(In millions of euros)

	Nominal amount	December 31, 2006	
		Equity component	Financial debt
8% convertible securities	369	76	298
7.75% convertible securities	837	142	726
2.875% Series A convertible debentures	569	237	349
2.875% Series B convertible debentures	669	306	392
<b>TOTAL</b>	<b>2,444</b>	<b>761</b>	<b>1,765</b>

**2.875% Series A and B Convertible Debentures**

Alcatel-Lucent launched a joint solicitation of consent from holders of record as of December 14, 2006, of Lucent's 2.75% Series A Convertible Senior Debentures due 2023 and 2.75% Series B Convertible Senior Debentures due 2025 (collectively, "the Debentures") to amend the Indenture for the Debentures, in return for a full and unconditional guaranty from Alcatel-Lucent, which is unsecured and subordinated to its senior debt, a one time adjustment to the conversion ratio, a further adjustment to the conversion ratios upon cash dividends or distributions on Alcatel-Lucent ordinary shares in excess of €0.08 per share annually and a change of the interest rate to 2.875% from 2.75%.

The amendment allows Alcatel-Lucent to provide such information, documents and other reports that are required to be filed by Alcatel-Lucent pursuant to sections 13 and 15(d) of the U.S. Securities Exchange Act of 1934, to holders of the Debentures, instead of having to produce separate statements for Lucent after the completion of the merger. The consent solicitation was completed on December 29, 2006. As a result, the following terms of Lucent's 2.75% convertible senior debentures were modified as follows:

	Series A		Series B	
	Old Terms	New Terms	Old Terms	New Terms
Coupon rate	2.75%	2.875%	2.75%	2.875%
Conversion ratio	58.4431	59.7015	62.5641	65.1465

The benefit granted to the bondholders corresponding to the adjustment of the conversion ratio amounted to €18 million and has been accounted for as an "Other financial loss" in 2006 (see Note 8).

The debentures rank equal in priority with all of the existing and future unsecured and unsubordinated indebtedness and senior in right of payment to all of Lucent's existing and future subordinated indebtedness. The terms governing the debentures limit the ability to create liens, secure certain indebtedness and merge with or sell substantially all of its assets to another entity.

As a result of the acquisition, the debentures are convertible into Alcatel-Lucent ADSs (American Depositary Shares) and cash in lieu of fractional ADSs. The debentures are convertible into ADSs only if (1) the sale price of the ADSs for at least twenty trading days during the period of thirty consecutive trading days ending on the last trading day of the previous calendar quarter is greater than or equal to 120% of the applicable conversion price, (2) the trading price of the debentures is less than 97% of the product of the sale price of the ADSs and the conversion rate during any five consecutive trading-day period, (3) the debentures have been called for redemption by Lucent or (4) certain specified corporate actions occur.

At Lucent's option, the debentures are redeemable for cash after certain dates (optional redemption periods) at 100% of the principal amount plus any accrued and unpaid interest. In addition, at Lucent's option, the debentures are redeemable earlier (provisional redemption periods) if the sale price of the ADSs exceeds 130% of the applicable conversion price. Under these circumstances, the redemption price would also include a make-whole payment equal to the present value of all remaining scheduled interest payments through the end of the optional redemption periods.

At the option of the holder, the debentures are redeemable on certain dates at 100% of the principal amount plus any accrued and unpaid interest. In these circumstances, Lucent may pay the purchase price with cash, ADSs (with the ADSs to be valued at a 5% discount from the then current market price) or a combination of both.

The following table summarizes the specific terms of these securities.



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	Series A	Series B
Amount	\$750,000,000	\$880,500,000
Conversion ratio	59.7015	65.1465
Conversion price	\$16.75	\$15.35
Redemption periods at the option of the issuer:		
Provisional redemption periods	June 20, 2008 through June 19, 2010	June 20, 2009 through June 19, 2013
Optional redemption periods	After June 19, 2010	After June 19, 2013
Redemption dates at the option of the holder	June 15, 2010, 2015 and 2020	June 15, 2013 and 2019
Maturity dates	June 15, 2023	June 15, 2025

The effective rate of interest of the debt component is 6.70% for series A and 6.73% for series B.

At December 31, 2006, the fair value of the debt component of the convertible bonds was €349 million for series A and €386 million for series B (see Note 26h) and the market value of the convertible bonds was €613 million for series A et €744 million for series B.

#### **7.75% Convertible Securities (Liability to Subsidiary Trust Issuing Preferred Securities)**

During fiscal 2002, Lucent Technologies Capital Trust I (the Trust) sold 7.75% cumulative convertible trust preferred securities for an aggregate amount of \$1.75 billion. The Trust used the proceeds to purchase Lucent Technologies Inc 7.75% convertible subordinated debentures due March 15, 2017, which represent all of the Trust's assets. The terms of the trust preferred securities are substantially the same as the terms of the debentures. Lucent Technologies Inc owns all of the common securities of the Trust and as a result consolidates the Trust.

Lucent may redeem the debentures, in whole or in part, for cash at premiums ranging from 103.88% beginning March 20, 2007, to 100.00% on March 20, 2012 and thereafter. To the extent Lucent redeems debentures, the Trust is required to redeem a corresponding amount of trust preferred securities. Lucent has irrevocably and unconditionally guaranteed, on a subordinated basis, the payments due on the trust preferred securities to the extent Lucent make payments on the debentures to the Trust.

The ability of the Trust to pay dividends depends on the receipt of interest payments on the debentures. Lucent has the right to defer payments of interest on the debentures for up to 20 consecutive quarters. If payment of interest on the debentures is deferred, the Trust will defer the quarterly distributions on the trust preferred securities for a corresponding period. Deferred interest accrues at an annual rate of 9.25%. At the option of the holder, each trust preferred security is convertible into Alcatel-Lucent ADSs, subject to an additional adjustment under certain circumstances. The following table summarizes the terms of this security.

Conversion ratio	40.3306
Conversion price	\$24.80
Redemption period at Lucent option	After March 19, 2007
Maturity date	March 15, 2017

The effective rate of interest of the debt component is 9.86%.

At December 31, 2006, the fair value of the debt component of the convertible bonds was €725 million (see Note 26h) and the market value of the convertible bonds was €853 million.

#### **8% Convertible Securities**

The following table summarizes the terms of this security.

Conversion ratio	32.8620
Conversion price	\$30.43
Redemption period at the option of the issuer	After August 14, 2006
Redemption dates at the option of the holder	On August 2, 2007, 2010 and 2016
Mandatory redemption date	August 1, 2031

At the option of the holder, the debentures are redeemable on certain dates at 100% of the principal amount plus any accrued and unpaid interest. In these circumstances, Lucent may pay the purchase price with cash, ADSs (with the ADSs to be valued at a 5% discount from the then current market price) or a combination of both.

The effective rate of interest of the debt component is 10.14%.

At December 31, 2006, the fair value of the debt component of the convertible bonds was €314 million (see Note 26h) and the market value of the convertible bonds was €373 million.

## **Note 25 – Pensions, retirement indemnities and other post-retirement benefits**

In accordance with the laws and customs of each country, the Group provides to its employees pension plans, certain medical insurance and reimbursement of medical expenses. In France, Group employees benefit from a retirement indemnity plan. In other countries, the plans depend upon local legislation, the business and the historical practice of the subsidiary concerned.

Over and above state pension plans, the plans can be defined contribution plans or defined benefit plans. In the latter case, the plans are wholly or partially funded by assets solely to support such plans (listed shares, bonds, insurance contracts or other types of dedicated investments).

### **State plans**

In certain countries, and more particularly in France and Italy, the Group participates in mandatory social security plans organized at state or industry level, for which contributions expensed correspond to the contributions due to such state or equivalent organizations. Such plans are considered to be defined contribution plans. However, in certain countries, the element of social security contributions paid that relates to pension plans is not clearly identifiable.

### **Other defined contribution plans**

The benefits paid out depend solely on the amount of contributions paid into the plan and the investment returns arising from the contributions. The Group's obligation is limited to the amount of contributions that are expensed. Contributions made to defined contribution plans (excluding mandatory social security plans organized at state or industry level) are €56 million for 2006 (€40 million for 2005 and €40 million for 2004).

### **Defined benefit plans**

Independent actuaries calculate annually the Group's obligation in respect of these plans, using the projected unit credit method. Actuarial assumptions comprise mortality, rates of employee turnover, projection of future salary levels and revaluation of future benefits. Future estimated benefits are discounted using discount rates appropriate to each country. These plans have differing characteristics:

- life annuity: the retirees benefit from receiving a pension during their retirement. These plans are to be found primarily in Germany, United Kingdom and the United States;
- lump-sum payment on the employee's retirement or departure. These plans are to be found primarily in France, Belgium and Italy;
- post-employment medical care during retirement. In the United States, Alcatel-Lucent reimburses medical expenses of certain retired employees.

Pensions and retirement obligations are determined in accordance with the Accounting Policies presented in Note 1k.

For retirement plans, actuarial gains and losses are recognized as income or expense in accordance with the "corridor" method (net cumulative actuarial gains and losses exceeding the greater of 10% of the present value of the defined benefit obligations and 10% of the fair value of the plan assets are amortized as income or expense over the expected average remaining working period).

For plans providing for the reimbursement of medical expenses, actuarial gains and losses are recognized as income or expense over the average remaining working period or 100% in the following year for participants who are no longer working.

For former Lucent activities, Alcatel-Lucent maintain defined benefit pension plans covering the majority of US employees and retirees, as well as other post-retirement benefit plans for U.S. retirees that include health care, dental benefits and life insurance coverage. The U.S. pension plans feature a traditional service-based program, as well as a Cash Balance Program. The Cash Balance Program was added to the defined benefit pension plan for U.S. management employees hired after December 31, 1998. No employees were transitioned from traditional program to Cash Balance Program. Additionally, employees covered by the Cash Balance Program are not eligible to receive company-paid post-retirement health and group life coverage. U.S. management employees with less than 15 years of service as of June 30, 2001 are not eligible to receive post-retirement group life and health care benefits. Alcatel-Lucent also maintains defined benefit pension plans in 14 countries outside the U.S. that comprise approximately 2.8% of its pension plan assets and 3.7% of its pension plan obligations as of December 31, 2006.



[Back to Contents](#)**(a) Actuarial Assumption**

To determine actuarial valuations, actuaries have determined general assumptions on a country-by-country basis and specific assumptions (rate of employee turnover, salary increases) company by company. The assumptions for 2006, 2005 and 2004 are as follows (the rates indicated are weighted average rates):

(In millions of euros)	2006	2005	2004
Discount rate	5.54%	3.95%	4.46%
Future salary increases	3.90%	3.34%	3.52%
Expected long-term return on assets	7.35%	4.28%	4.70%
Post-retirement cost trend rate	9.40% to 5.00%	7.50%	7.50%
Average residual active life	15-27 years	15-27 years	15-27 years

The above rates are broken down by geographical segment as follows for 2006, 2005 and 2004:

	Discount rate	Future salary increases	Expected long-term return on assets
<b>2006</b>			
France	4.10%	3.41%	5.10%
Belgium	4.11%	3.71%	4.48%
United Kingdom	5.21%	4.53%	6.59%
Germany	4.13%	2.76%	4.26%
Rest of Europe	4.20%	2.54%	4.14%
United States of America	5.72%	4.01%	7.62%
Other	4.12%	4.18%	4.35%
<b>2005</b>			
France	3.75%	3.49%	4.27%
Belgium	3.75%	3.70%	3.75%
United Kingdom	5.00%	4.25%	6.50%
Germany	3.75%	2.75%	3.50%
Rest of Europe	3.32%	2.86%	3.85%
North America	4.98%	4.93%	5.37%
Other	4.25%	4.89%	5.12%
<b>2004</b>			
France	4.32%	2.82%	4.73%
Belgium	4.30%	5.98%	4.00%
United Kingdom	5.25%	4.50%	6.50%
Germany	4.31%	2.75%	4.50%
Rest of Europe	3.96%	2.55%	4.68%
North America	5.27%	4.76%	5.37%
Other	5.03%	4.16%	3.37%

The discount rates are obtained by reference to market yields on high quality bonds (government and prime-rated corporations – AA or AAA) in each country having maturity dates equivalent to those of the plans.

The returns on plan assets are determined plan by plan and depend upon the asset allocation of the investment portfolio and the expected future performance.

[Back to Contents](#)**(b) Components of Net Periodic Cost of post-Employment Benefit Plans***(In millions of euros)*

	2006	2005	2004
Service cost	(73)	(60)	(72)
Interest cost	(256)	(139)	(146)
Expected return on plan assets	286	93	96
Amortization of prior service cost	(4)	-	-
Amortization of recognized actuarial gain / (loss)	(7)	8	5
Effect of curtailments	-	5	15
Effect of settlements	(1)	-	-
Effect of adjustment on net assets <sup>(1)</sup>	(65)	-	(2)
<b>NET PERIODIC BENEFIT COST</b>	<b>(120)</b>	<b>(93)</b>	<b>(104)</b>
Of which:	(71)	(47)	(54)
• recognized in Income (loss) from operating activities before restructuring costs, Impairment of intangible assets and gain / (loss) on disposal of consolidated entities			
• recognized in other financial income (loss)	(49)	(46)	(50)

*(1) Mainly related to the asset ceiling impact in 2006, presented in other financial loss.*

[Back to Contents](#)**(c) The change in the obligation recorded in the balance sheet is as follows:***(In millions of euros)*

	2006	2005	2004
<b>CHANGE IN BENEFIT OBLIGATION</b>			
<b>Benefit obligation at January 1</b>	<b>(3,503)</b>	<b>(3,289)</b>	<b>(3,219)</b>
Service cost	(73)	(60)	(72)
Interest cost	(256)	(139)	(146)
Plan participants' contributions	(15)	(5)	(4)
Amendments	(5)	-	(72)
Business combinations	(27,694)	(31)	-
Disposals	138	2	53
Curtailments	2	7	14
Settlements	14	26	19
Special termination benefits	1	(2)	0
Actuarial (gains) and losses	759	(129)	(46)
Benefits paid	434	177	166
Other (foreign currency translation)	(32)	(60)	18
<b>Benefit obligation at December 31</b>	<b>(30,230)</b>	<b>(3,503)</b>	<b>(3,289)</b>
Benefit obligation excluding effect of future salary increases	(29,659)	(3,237)	(2,941)
Effect of future salary increases	(571)	(266)	(348)
<b>Benefit obligation</b>	<b>(30,230)</b>	<b>(3,503)</b>	<b>(3,289)</b>
Pertaining to retirement plans	(25,848)	(3,483)	(3,272)
Pertaining to post-employment medical care plans	(4,382)	(20)	(17)
<b>CHANGE IN PLAN ASSETS</b>			
<b>Fair value of plan assets at January 1</b>	<b>2,286</b>	<b>2,106</b>	<b>1,974</b>
Expected return on plan assets	286	93	96
Actuarial gains and (losses)	57	111	47
Employers' contributions	129	80	84
Plan participants' contributions	15	5	4
Amendments	-	-	32
Business combinations	27,825	-	-
Disposals	(30)	-	-
Curtailments	-	-	-
Settlements	(14)	(26)	(15)
Benefits paid / Special termination benefits	(395)	(117)	(108)
Other (foreign currency translation)	38	34	(8)
<b>Fair value of plan assets at December 31</b>	<b>30,197</b>	<b>2,286</b>	<b>2,106</b>
Present value of defined benefit obligations that are wholly or partly funded	(27,984)	(2,433)	(2,330)
Fair value of plan assets	30,197	2,286	2,106
<b>Funded status of defined benefit obligations that are wholly or partly funded</b>	<b>2,213</b>	<b>(147)</b>	<b>(224)</b>
Present value of defined benefit obligations that are wholly unfunded	(2,246)	(1,070)	(959)
<b>Funded status</b>	<b>(33)</b>	<b>(1,217)</b>	<b>(1,183)</b>
Unrecognized actuarial losses / (gains)	(691)	46	9
Unrecognized prior service cost	1	-	-
Unrecognized surplus (due to application of asset ceiling)	(1,874)	(3)	(5)
<b>NET AMOUNT RECOGNIZED</b>	<b>(2,597)</b>	<b>(1,174)</b>	<b>(1,179)</b>
of which:	2,734	294	287
• prepaid pension costs			
• pensions, retirement indemnities and other post-retirement benefits	(5,331)	(1,468)	(1,466)

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Funding requirements are usually determined for each individual plan, and as a result excess plan assets for overfunded plans cannot be used for underfunded plans. The unfunded status, which amounted to €33 million at December 31, 2006 (€1,217 million at December 31, 2005 and €1,183 million at December 31, 2004) relates primarily to Lucent's post-retirement benefits (see below) and to plans in France and Germany. Decisions on funding the benefit obligations are taken based on each country's legal requirements and the tax-deductibility of the contributions made. In France and Germany, the funding of pension obligations relies primarily on defined contribution plans; setting up other funding arrangements is not common practice. Furthermore in Germany the benefits accruing to employees are guaranteed in the event of bankruptcy through a system of mutual insurance common to all companies involved in similar plans. See section D below for information on Lucent's plans.

The benefit obligation, the fair value of the plan assets and the actuarial gains (losses) generated for the current year and the previous year are as follows:

	Benefit obligation (In millions of euros)	Plan assets	Funded (unfunded) status	Experience adjustments generated on the benefit obligation		Experience adjustments generated on the plan assets	
				Amount	In percentage of the benefit obligation	Amount	In percentage of the plan assets
2006	(30,230)	30,197	(33)	21	0.07%	57	0.19%
2005	(3,503)	2,286	(1,217)	72	2.06%	111	4.86%
2004	(3,289)	2,106	(1,183)	6	0.18%	47	2.23%

In respect of the medical care plans, a change of one percentage point in the assumed medical costs has the following impact:  
(In millions of euros)

	Increase of 1%	Decrease of 1%
Impact on the current service cost and interest costs	(1)	1
Impact on the benefit obligation	(163)	147

The plan assets of retirement plans are invested as follows:  
(In millions of euros and percentage)

	Bonds	Equity Securities	Short-term Investments	Property assets	Total
2006	14,382 48%	10,966 36%	2,537 8%	2,312 8%	30,197 100%
2005	941 41%	626 28%	348 15%	371 16%	2,286 100%
2004	853 41%	576 27%	365 17%	312 15%	2,106 100%

For former Alcatel companies, the investment policy relating to plan assets within the Group depends upon local practices. In all cases, the proportion of equity securities cannot exceed 80% of plan assets and no individual equity security may represent more than 5% of total equity securities within the plan. The equity securities held by the plan must be listed on a recognized exchange. The bonds held by the plan must have a minimum "A" rating according to Standard & Poor's or Moody's rating criteria.

The contributions that are expected to be paid for 2007 are €245 million for the pension and other post-retirement benefits plans.

#### (d) Lucent's Pension and post-Retirement Obligations

The following tables summarize changes in the benefit obligation, the plan assets and the funded status of Lucent's pension and post-retirement benefit plans as well as the components of net periodic benefit costs, including key assumptions. The measurement dates for plan assets and obligations were December 31, 2006 and November 30, 2006.

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December 31, 2006 (in millions)				
	Pension benefits		Post-retirement benefits	
	US\$	€	US\$	€
<b>Change in benefit obligation:</b>				
Benefit obligation at November 30, 2006	(30,640)	(23,208)	(5,922)	(4,486)
Service cost	(13)	(10)	(1)	(1)
Interest cost	(139)	(105)	(26)	(19)
Actuarial (gains) losses	724	548	100	76
Amendments	-	-	-	-
Benefits paid	210	159	109	83
Plan participant contributions	-	-	(14)	(11)
Settlements	-	-	-	-
Curtailments	-	-	-	-
Exchange rate changes	1	(54)	-	(11)
Other	-	-	-	-
<b>Benefit obligation at end of year</b>	<b>(29,857)</b>	<b>(22,670)</b>	<b>(5,754)</b>	<b>(4,369)</b>
<b>Change in plan assets:</b>				
Fair value of plan assets at November 30, 2006	36,028	27,290	706	535
Actual return on plan assets	113	86	5	4
Benefits paid	(210)	(159)	(134)	(101)
Plan participant contributions	-	-	14	11
Company contributions	8	6	50	38
Section 420 transfer	(504)	(382)	504	382
Exchange rate changes	(2)	63	-	1
Settlement	-	-	-	-
Other	-	-	(5)	(4)
<b>Fair value of plan assets at end of year</b>	<b>35,433</b>	<b>26,904</b>	<b>1,140</b>	<b>866</b>
Funded status of the plan	5,576	4,234	(4,614)	(3,503)
Unrecognized net loss (gain)	(516)	(392)	(100)	(76)
Unrecognized prior service cost (credit)	-	-	-	-
Unrecognized surplus due to asset ceiling	(2,460)	(1,868)	-	-
<b>Net asset (liability) recognized</b>	<b>2,600</b>	<b>1,974</b>	<b>(4,714)</b>	<b>(3,579)</b>
<b>Amounts recognized in the consolidated balance sheets:</b>				
Prepaid pension costs	3,183	2,416	-	-
Pensions, retirement indemnities and other post-retirement benefits	(583)	(442)	(4,714)	(3,579)
<b>Net asset (liability) recognized</b>	<b>2,600</b>	<b>1,974</b>	<b>(4,714)</b>	<b>(3,579)</b>

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December 31, 2006 (in millions)

	Pension benefits		Post-retirement Benefits	
	US\$	€	US\$	€
<b>Benefit obligation by major plans:</b>				
U.S. management	(17,216)	(13,072)	-	-
U.S. occupational	(11,129)	(8,450)	-	-
Non-U.S. and supplemental	(1,512)	(1,148)	-	-
Non-represented health	-	-	(1,296)	(984)
Formerly represented health	-	-	(2,945)	(2,236)
Group life and other	-	-	(1,513)	(1,149)
<b>Benefit obligation at end of year</b>	<b>(29,857)</b>	<b>(22,670)</b>	<b>(5,754)</b>	<b>(4,369)</b>
<b>Plan assets by major plans:</b>				
U.S. management	17,875	13,573	-	-
U.S. occupational	16,570	12,581	-	-
Non-U.S. and supplemental	988	750	-	-
Formerly represented health	-	-	476	362
Group life and other	-	-	664	504
<b>Fair value of plan assets at end of year</b>	<b>35,433</b>	<b>26,904</b>	<b>1,140</b>	<b>866</b>

**Components of Net Periodic Benefit Cost**

December 31, 2006 (in millions)

	Pension benefits		Post-retirement Benefits	
	US\$	€	US\$	€
<b>Pension credit / post-retirement benefit cost:</b>				
Service cost	(13)	(10)	(1)	(1)
Interest cost on benefit obligation	(139)	(105)	(26)	(19)
Expected return on plan assets	226	171	4	3
Amortization of net (loss) gain	-	-	-	-
Amortization of unrecognized prior service costs	-	-	-	-
Effect of adjustment on net asset	(80)	(61)	-	-
<b>Subtotal</b>	<b>(6)</b>	<b>(5)</b>	<b>(23)</b>	<b>(17)</b>
Termination benefits	-	-	-	-
Curtailments	-	-	-	-
Settlements	-	-	-	-
<b>Pension credit / post-retirement benefit cost</b>	<b>(6)</b>	<b>(5)</b>	<b>(23)</b>	<b>(17)</b>
Business restructuring	-	-	-	-
Other costs and expenses	-	-	-	-
<b>Pension credit / post-retirement benefit cost</b>	<b>(6)</b>	<b>(5)</b>	<b>(23)</b>	<b>(17)</b>



[Back to Contents](#)**Key Assumptions****Assumptions used to determine:**

	<b>2006</b>
<b>Benefit obligations – discount rate:</b>	
Pension	5.75%
Post-retirement health care and other	5.50%
Post-retirement life	5.75%
Rate of compensation increase	4.00%
<b>Net cost or credit – discount rate:</b>	
Pension	5.50%
Post-retirement health care and other	5.25%
Post-retirement life	5.50%
<b>Expected return on plan assets:</b>	
Pension	7.65%
Post-retirement health care	5.25%
Post-retirement life	7.25%

The weighted average expected rate of return on plan assets that will be used to determine the calendar 2007 net periodic benefit cost is 7.65% for pensions, 5.25% for post-retirement health care benefits and 7.25% for post-retirement life benefits. The weighted average 7.65% expected rate of return on plan assets is mainly based on a 8.50% rate of the management pension plan and a 6.75% rate for the occupational pension plan.

**December 31, 2006****Assumed health care cost trend rates:**

Health care cost trend rate assumed for next year	9.20%
Health care cost trend rate assumed for next year (excluding post-retirement dental benefits)	9.40%
Rate that the cost trend rate gradually declines to	5.00%
Year that the rate reaches the rate it is assumed to remain at	2014

The assumed health care cost trend rate has a significant effect on the amounts reported. A one-percentage-point change in the assumed health care cost trend rate would have the following effects:

	1 percentage point	
	Increase	Decrease
Effect on total of service and interest cost components	(1)	1
Effect on post-retirement benefit obligation	(215)	193

Yield curves matching Lucent benefit obligations were derived from 30-year Treasury rates. The resulting risk free rates from these yield curves were adjusted to available yields on high-quality corporate fixed income investments with maturities corresponding to its benefit obligations to develop discount rates at each measurement date. Yields and changes in yields of several funds, as well as the original Citigroup pension yield curve, were also considered in setting the discount rates. The average duration of Lucent primary pension obligations and post-retirement health care obligations were 10.0 years and 6.2 years, respectively, as of December 31, 2006.

Lucent considered several factors in developing its expected rate of return on plan assets, including our historical returns and input from its external advisors. Individual asset class return forecasts were developed based upon current market conditions, for example, price-earnings levels and yields and long-term growth expectations. The expected long-term rate of return is the weighted average of the target asset allocation of each individual asset class. The projected market returns received from its external advisors were 8.2% for Lucent management plan and 6.5% for Lucent occupational plan as of December 31, 2006. Lucent considered this projection and included an anticipated premium in developing its long-term expected rate of return on plan assets and retained a 8.50% expected rate of return on plan assets for the management pension plan and a 6.75% expected rate of return on plan assets for the occupational pension plan.

On December 8, 2003, the President of the United States signed the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the Act). The Act introduced a prescription drug benefit under Medicare (Medicare Part D), as well as a federal subsidy to sponsors of retiree health care benefits plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Lucent currently sponsor retiree health care plans that provide prescription drug benefits to its U.S. retirees that its plan actuaries have determined are actuarially equivalent to Medicare Part D.

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Lucent elected to prospectively recognize the effects of the Act during the fourth quarter of fiscal 2004, which reduced the accumulated post-retirement benefit obligation by approximately \$600 million. On January 21, 2005, the Centers for Medicare and Medicaid Services issued a Final Rule in the Federal Register for implementing the Medicare Prescription Drug Benefit that clarified the methodology for determining actuarial equivalence and the amount of the federal subsidy. The impact of the Final Rule did not materially affect Lucent post-retirement benefit cost and related obligation.

#### **Plan Assets**

The following table summarizes the weighted average target asset allocation ranges and Lucent actual allocation of its pension and post-retirement trusts by asset category as of December 31, 2006.

December 31, 2006	Pension target allocation range	Percentage of plan assets	Post-retirement target allocation	Percentage of post-retirement plan assets
<b>Asset category:</b>				
Equity securities	31% – 48%	37%	42%	29%
Fixed income securities	41% – 57%	48%	58%	37%
Real estate	4% – 8%	7%	n/a	-
Private equity and other	5% – 9%	8%	n/a	-
Cash	0%	0%	n/a	34%
<b>TOTAL</b>		<b>100%</b>		<b>100%</b>

The majority of the pension plan assets are held in a master pension trust. Post-retirement plan assets are held in three separate trusts in addition to the amount set aside in the master pension trust for retiree healthcare. Plan assets are managed by independent investment advisors with the objective of maximizing returns with a prudent level of risk. Lucent periodically complete asset-liability studies to assure that the optimal asset allocation is maintained in order to meet future benefit obligations. An Asset Allocation Committee appointed by Lucent's Board of Directors formally approves the target allocation ranges every three to five years upon completion of a study by the external advisors to the plans. During 2006, the allocation of the U.S. occupational pension plan assets was changed as part of a routine periodic review. The overall pension plan asset portfolio reflects a balance of investments split about a blended basis between equity and fixed income securities compared to the previous split of about 75 percent equity and 25 percent fixed income. Lucent believes this action was prudent given the demographics, funded status and future obligations for its pension plans. Investment advisors managing plan assets may use derivative financial instruments including futures contracts, forward contracts, options and interest rate swaps to manage market risk.

Pension plan assets included \$2 million and \$1 million of Alcatel-Lucent ADSs (American Depository Shares) as of December 31, 2006 and November 30, 2006, respectively.

#### **Contributions**

Lucent may contribute to its pension and post-retirement benefit plans to make benefit payments to plan participants and to pre-fund some benefits by means of trust funds. For Lucent's U.S. pension plans, the funding policy is to contribute amounts to the trusts sufficient to meet minimum funding requirements as set forth in employee benefit and tax laws plus such additional amounts as Lucent may determine to be appropriate. Contributions are made to benefit plans for the sole benefit of plan participants.

On December 27, 2006, Lucent made a Section 420 "collectively bargained transfer" of excess pension assets from the occupational pension plan in the amount of \$504 million to fund healthcare benefits for formerly represented retirees for the period beginning October 1, 2006 through December 31, 2007.

The following table summarizes expected contributions (net of Medicare Part D subsidies) to its various pension and post-retirement plans through calendar 2016. Lucent does not expect to make contributions to its qualified U.S. pension plans during calendar 2007 or 2008. Lucent is unable to estimate the expected contributions to its qualified U.S. pension plans beyond calendar 2008. Actual contributions may differ from expected contributions, due to various factors, including performance of plan assets, interest rates and potential legislative and regulatory changes. The table below reflects the use of the \$504 million in excess pension assets for funding retiree healthcare for formerly represented retirees through December 31, 2007, but does not assume any further Section 420 transfer.

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(In millions of US\$)

	Pension Non-qualified and non-U.S. pension plans	Formerly represented retiree health plans	Post-retirement Non-represented retiree health plans	Other benefit plans
2007	64	(37)	164	10
2008	63	234	150	10
2009	64	333	143	10
2010	66	317	135	10
2011	67	299	126	10
2012-16	315	1,302	510	201

**Benefit Payments**

The following table summarizes expected benefit payments from Lucent's various pension and post-retirement plans through calendar 2016 on the basis of current plan design. Actual benefit payments may differ from expected benefit payments. These amounts are reflected net of expected plan participant contributions and the annual Medicare Part D subsidy of approximately \$70 million.

(in millions of US\$)

	Qualified U.S. management pension plans	Pension Qualified U.S. occupational pension plans	Non-qualified and non-U.S. pension plans	Formerly represented retiree health plans	Post-retirement Non-represented retiree health plans	Other benefit plans
2007	1,342	1,050	59	362	164	92
2008	1,330	1,025	60	338	150	95
2009	1,317	1,001	60	333	143	96
2010	1,304	975	62	317	135	98
2011	1,292	950	63	299	126	99
2012-16	6,290	4,361	341	1,302	510	504

**Note 26 – Financial debt****(a) Analysis of Financial Debt, Net**

(In millions of euros)

	2006	2005	2004
Marketable securities – short-term, net	1,245	640	552
Marketable securities – long-term, net	697	-	-
Cash and cash equivalents	4,749	4,510	4,611
<b>Cash, cash equivalents and marketable securities</b>	<b>6,691</b>	<b>5,150</b>	<b>5,163</b>
(Convertible and other bonds – long-term portion)	(4,901)	(2,393)	(3,089)
(Other long-term debt)	(147)	(359)	(402)
(Current portion of long-term debt)	(1,161)	(1,046)	(1,115)
<b>(Financial debt, gross)</b>	<b>(6,209)</b>	<b>(3,798)</b>	<b>(4,606)</b>
Derivative interest rate instruments – other current and non-current assets	36	178	148
Derivative interest rate instruments – other current and non-current liabilities	(10)	(71)	(43)
<b>CASH (FINANCIAL DEBT), NET</b>	<b>508</b>	<b>1,459</b>	<b>662</b>

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<i>(In millions of euros)</i>	2006	2005	2004
Convertible bonds	2,682	901	886
Other bonds	2,672	1,960	2,788
Bank loans and overdrafts and other financial debt	504	629	687
Commercial paper	138	127	61
Finance lease obligations	52	60	45
Accrued interest	161	121	139
<b>FINANCIAL DEBT, GROSS</b>	<b>6,209</b>	<b>3,798</b>	<b>4,606</b>

**(c) Bonds**

Balances at December 31, 2005 and at December 31, 2006:

<b>Remaining amounts to be reimbursed</b> <i>(In millions of euros)</i>	December 31, 2005	Change in consolidated companies	Changes during 2006	December 31, 2006
<b>Originally issued by Alcatel:</b>				
• Zero-rate coupon due June 2006	37		(37)	-
• 7% EUR due December 2006	426		(426)	-
• 5.625% EUR due March 2007	154		-	154
• 4.375% EUR due February 2009	859		(54)	805
• OCEANE 4,75% due January 2011	1,022		-	1,022
• 6.375% EUR due April 2014	462		-	462
<b>Originally issued by Lucent:</b>				
• 8% US\$ due August 2031 <sup>(1)</sup>	-	374	1	375
• 7.75% US\$ due March 2017 <sup>(1)</sup>	-	866	2	868
• 2.875% US\$ Series A due June 2023 <sup>(1)</sup>	-	584	2	586
• 2.875% US\$ Series B due June 2025 <sup>(1)</sup>	-	696	2	698
• 6.50% US\$ due January 2028	-	205		205
• 6.45% US\$ due March 2029	-	927	3	930
• 5.50% US\$ due November 2008	-	153	-	153
<b>Sub-total</b>	<b>2,960</b>	<b>3,805</b>	<b>(507)</b>	<b>6,258</b>
Equity component of OCEANE	(126)		22	(104)
Equity component of convertible bonds issued by Lucent		(762)	-	(762)
Fair value of interest rate instruments relating to bonds and expenses included in the calculation of the effective interest rate	27	(3)	(62)	(38)
<b>CARRYING AMOUNT OF BONDS</b>	<b>2,861</b>	<b>3,040</b>	<b>(547)</b>	<b>5,354</b>

<sup>(1)</sup> See Note 24 for details on Put and Call options.**Convertible Bonds**

The characteristics of these bonds and how they are recognized are detailed in Notes 24b et 24c.

**Other Bonds****Changes in 2006**

• Repurchases